IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. ——.

LEGH R. POWELL, JR. and HENRY W. ANDERSON, as Receivers of the Properties of Seaboard Air Line Railway Company,

Petitioners,

against

MARYLAND TRUST COMPANY, as Successor Trustee under the First Mortgage of Seaboard Air Line Railway dated April 14, 1900.

Respondent.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

OPINIONS OF THE COURTS BELOW.

The report of the Special Master to whom this case was referred by the District Court will be found beginning at page 132 of the Record. The decree of the District Court will be found beginning at page 192 of the Record, and its memorandum at page 185. The opinion of the Circuit Court of Appeals (R. 194) has not yet been reported.

JURISDICTION.

As stated in the petition, the decree of the Circuit Court of Appeals to be reviewed was entered January 6, 1942 (R. 199). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, chap. 229, 43 Stat. 938; 28 U. S. C. A., Sec. 347(a).

STATEMENT OF THE FACTS.

The facts are not in dispute. They have been agreed upon in a stipulation and a supplement thereto, signed by counsel for all parties to the appeals below (R. 1, 131). The material facts will be briefly summarized in order that the contentions of the parties may be better understood.

On or about September 28, 1901 the Railway Company delivered to The Continental Trust Company, as Trustee under the First Mortgage (Maryland Trust Company being now the successor Trustee), certificates for 4,450 shares of the capital stock of Richmond-Washington Company. These shares were purchased with funds obtained by the Railway Company from the sale of Refunding Collateral Trust Bonds pursuant to a Trust Agreement, dated May 1, 1901, between the Railway Company and Central Trust Company of New York, as Trustee, and in accordance with that agreement the shares were delivered to The Continental Trust Company to be subjected to the lien of the First Mortgage. The pertinent pledge provisions of this Mortgage are shown on pages 6, et seq., *infra*, of this brief.

Subsequently, the Railway Company executed and delivered to The New York Trust Company and Mortimer N. Buckner, as Trustees, its Refunding Mortgage, dated October 1, 1909. The granting clauses of that Mortgage specifically refer to Richmond-Washington Company stock. Sub-clause (b) of Clause Third of the granting clauses in part provides:

> "(b) The following bonds and shares of stock subject to the lien of the Seaboard First Mortgage, and to the lien of the Three-Year Mortgage, and now in possession of The Continental Trust Company, Baltimore, Maryland, Trustee of the Seaboard First Mortgage:
>
> "1. 4,450 shares of the capital stock of Richmond-Washington Company;"

Sub-clause (g) of that clause, among other things, provides:

> "(g) All shares of stock of any of the companies shares of stock whereof are pledged or agreed to be pledged hereunder in the foregoing sub-clauses (a), (b), (d) and (e), which the Railway Company now owns or shall hereafter acquire; * * *"

Also, under Section 2 of ARTICLE THREE of that Mortgage the Railway Company covenanted to deliver, or cause to be delivered, such stock immediately upon the acquisition thereof.

The Richmond-Washington Company is a New Jersey corporation, whose certificate of incorporation was filed September 5, 1901. It is a holding company and controls $955,000 out of $1,316,900 par value

voting common stock and all of the non-voting common stock of the Richmond, Fredericksburg & Potomac Railroad Company. On October 31, 1930, and prior thereto, the capital stock of the Richmond-Washington Company was owned in equal parts, and continues so to be owned, by the Pennsylvania Railroad Company, the Baltimore & Ohio Railroad Company, the Atlantic Coast Line Railroad Company, the Southern Railway Company, the Seaboard Air Line Railway Company, and the Chesapeake and Ohio Railway Company. On that date the authorized capital stock of the Richmond-Washington Company was $3,000,000, divided into 30,000 shares having a par value of $100 per share. Also on that date there were issued and outstanding 26,700 shares of its capital stock, of which Seaboard Air Line Railway owned 4,450 shares, the same shares above referred to as pledged under the First Mortgage. The issued capital stock of the Richmond-Washington Company was increased on October 31, 1930 by the payment of a fifty per cent stock dividend, the payment of which had previously been approved by the directors and stockholders of the company at duly called meetings. This dividend represented a capitalization of surplus derived wholly from profits and earnings of the Company. As the 4,450 shares owned by the Railway Company, and held by the First Mortgage Trustee, were registered in the name of the Railway Company, the Railway Company prior to the Receivership received delivery of the fifty per cent stock dividend consisting of 2,225 shares. Upon receipt thereof the Railway Company continued to hold the certificates for the 2,225 shares, and upon the appointment of the Receivers of the Railway Company on December 23, 1930, the Receivers continued

and still continue to hold the certificates for such shares in their possession.

Between their appointment on December 23, 1930, and the submission of the case to a Special Master by the District Court the Receivers had been paid $53,400.00 in cash dividends upon the 4,450 shares held by the First Mortgage Trustee. These dividends were received from December 31, 1930 to December 30, 1931, inclusive. In addition, the Receivers have received cash dividends of $114,031.25 from December 31, 1930 to date upon the stock dividend of 2,225 shares in the possession of the Receivers. Further dividends after 1931 on the 4,450 shares have been paid to the First Mortgage Trustee by the Richmond-Washington Company on demand of the Trustee,—the Receivers having conceded the validity of the pledge of the 4,450 shares and the right to the cash dividends thereon declared after demand by the Trustee that further dividends on the 4,450 shares be paid to it. When this demand was made the First Mortgage Trustee neither demanded payment to it of the dividends collected by the Receivers nor delivery to it of the 2,225 shares.

As will be fully explained hereafter the stock dividend of 2,225 shares was declared and a certificate for this stock delivered to the Railway Company nearly two months prior to the appointment of the Receivers and at a time long prior to any event of default under the provisions of the First Mortgage. The First Mortgage was executed in 1901 by Seaboard Air Line Railway, the predecessor of Seaboard Air Line Railway Company, which came into existence in 1915 by certain merger and consolidation proceedings described in

detail in the stipulation of facts, and which thereafter assumed the obligations of the First Mortgage. The Mortgage was the financing medium under which bonds were issued and sold in connection with the acquisition of the stocks and certain other securities of some fifteen separate companies, the properties of which include those now subject as a first lien to the so-called Underlying Divisional Mortgages. The stocks of these constituent companies were pledged under the Mortgage, ARTICLE THREE of which, in eight separate sections, contains elaborate provisions for the protection of the rights of the trustee in the continued control through the pledge of these securities over the properties of the constituent companies. These provisions, sometimes referred to as "Dilution Clauses," are intended to prevent the Railway Company from acquiring through any device securities of the constituent companies other than those pledged under the mortgage in such a way as to impair the value of the security represented by the properties of the constituent companies and their pledged securities. Accordingly, these provisions of the mortgage require the pledge with the Mortgage Trustee of any additional stocks or other securities of these companies at any time thereafter acquired by the mortgagor, Seaboard Air Line Railway.

On the contrary the stock of Richmond-Washington Company is nowhere mentioned in the mortgage and the pledge of the 4,450 shares originally acquired by the Seaboard is nowhere specifically provided for. The pledge of this stock, conceded by all the parties as a valid one, was effected merely by delivery and without any formal instrument evidencing either de-

livery or pledge pursuant to Clause IV of the Granting Clauses,—a catch-all provision, which reads as follows:

> "Any and all other property of any kind, including stocks, bonds, claims or indebtedness, which from time to time hereafter may be conveyed and mortgaged or pledged and delivered or by writing of any kind assigned or transferred by the 'Railroad Company,' or by anyone in its behalf, to the 'Trustee,' which is hereby authorized at any and all times to receive any property as and for additional security, and also when and as hereinafter provided as substituted security for the bonds issued or to be issued hereunder, and to hold and apply any and all such property subject to the terms hereof."

The 4,450 shares were not paid for from the proceeds of any of the First Mortgage Bonds. On the contrary, as Section 18 of the stipulation shows (R. 16), these shares were acquired with the proceeds from the sale of $445,000 of Collateral Trust Bonds, which have since been paid off and retired. The retirement of the Collateral Trust Bonds was accomplished ultimately through the sale of Refunding Mortgage Bonds issued under the Refunding Mortgage of Seaboard Air Line Railway and it was doubtless in this connection that the Refunding Mortgage which is hereinafter more fully referred to provided specifically for the pledge of any subsequently acquired shares of stock of Richmond-Washington Company. Other pertinent provisions of the First Mortgage are as follows:

Section 2 of ARTICLE TWO, which contains the

covenants of the Railway Company, provides the customary covenant that the Railway Company will execute any other necessary instruments to protect the security and accomplish the purposes of the mortgage, but expressly disclaims any intention to "limit the right or power of the 'Railroad Company' * * * to own and hold, or to construct, or to acquire, other lines of railroad, or branches or extensions, or interests therein, *or other property*, free from the lien hereof." (Italics supplied.)

Section 8 of the covenants, which again is referable to the dilution clauses and to the securities of the constituent or underlying companies, provides:

> "Except subject to the lien hereof, or as herein otherwise expressly provided, the 'Railroad Company' (1) will not sell, encumber, or by any voluntary act part with its ownership of or title to any shares of stock of any company which shall have been pledged or assigned hereunder (if a majority of the shares of such company shall have been so pledged or assigned), or its equity of redemption therein, or the voting power thereon; and (2) will, subject to the lien hereof, hold all and singular such stock of every company of whose capital stock the greater part shall have been pledged or assigned hereunder, and will exercise its voting power thereon in such manner that it shall retain in itself the rights and powers of the holder of the greater part of the capital stock of such company; and (3) will at all times take all such action as from time to time may be necessary to preserve the corporate existence and corporate rights of every company of whose capital stock the greater part shall be pledged or assigned hereunder.

"As such holder of such stock it will not, by affirmative vote or by abstaining from voting, sanction or permit any increase of the capital stock of any such company, or the creation of any indebtedness of any such company (except current operating accounts for a period not at any time exceeding six months prior thereto), or the issue or guaranty of any bonds by such company, or the creation of any mortgage or other lien upon the railroad or property of any such company, unless effective provision be made that such indebtedness and the evidence thereof, and such bonds issued or guaranteed and such mortgage or other lien and all such additional stock (or such part of such additional stock as is proportionate to the part of such capital stock previously pledged or assigned hereunder), shall immediately, upon the issue or creation thereof, be delivered to and pledged with or assigned to the 'Trustee,' by it to be held subject to all the trust of this indenture, with the same effect as if all such indebtedness, bonds, mortgages or other liens or shares, as the case may be, had been delivered and pledged or assigned to it hereunder at the time of the making hereof, and all such additional stock shall be fully paid and non-assessable.

"Except as herein otherwise expressly provided, the 'Railroad Company' will not, by affirmative vote, or by abstaining from voting, sanction or permit any company, of whose capital stock the greater part shall be pledged or assigned hereunder, to sell or otherwise to dispose of its railroad, or to lease the same (unless such lease be terminable hereunder by entry of the 'Trustee' or by sale by the 'Trustee,' or pursuant to judicial proceedings), except to the 'Railroad Company,' or to some other company of whose capital stock there

> shall then be held by the 'Railroad Company,' or be pledged or assigned to the 'Trustee' hereunder, at least ninety-five per cent thereof, or a percentage not less than the percentage held hereunder of the capital stock of the company whose railroad shall be so sold or otherwise disposed of or leased, if such percentage of such last-named capital stock shall be less than ninety-five per cent of the entire amount thereof."

Section 1 of ARTICLE THREE, which deals with the "BONDS AND STOCKS PLEDGED HEREUNDER," expressly provides that unless and until the mortgagor Railroad Company shall be in default as the several defaults are specifically defined in the section:

> "The 'Trustee' (except with the assent of the 'Railroad Company') shall not collect or be entitled to collect the interest of any of the bonds or claims or indebtedness now or hereafter pledged with or assigned to the 'Trustee' under this indenture; *and the 'Railroad Company' shall be entitled to receive all interest paid or dividends declared in respect of any bonds or stocks transferred to or pledged with the 'Trustee' pursuant to any of the provisions of this indenture,* * * *. *In every such case the 'Railroad Company' shall be entitled for its own use to demand and receive and collect, release and discharge the principal or interest of any such claim against or indebtedness (other than bonds) of any other company pledged with the 'Trustee' hereunder; and upon the request of the 'Railroad Company' the 'Trustee' shall execute any reassignments or releases which may be required for that purpose.*" (Italics supplied.)

Section 3 of this article further provides that unless the Railroad Company shall be in default and such default shall have continued beyond the six months' period of grace previously defined, or unless the Trustee shall have entered into possession of the mortgaged properties, the Railroad Company

> "shall have the right to vote upon all shares of stock pledged hereunder, for all purposes not inconsistent with the provisions or purposes of this indenture, and with the same force and effect as though such pledge had not been made."

It was pursuant to these various provisions, clearly, as we contend, entitling it to do so, that the Seaboard voted the 4,450 shares of stock in favor of the stock dividend (R. 11) and continued to receive dividends not only on the 2,225 shares but also on the 4,450 shares until after default had occurred under the provisions of the mortgage. The facts with reference to the declaration of the stock dividend are shown in Sections 8 to 16, inclusive, of the stipulation (R. 9 et seq.), which are as follows:

> "8. R-W Co. is a New Jersey corporation whose certificate of incorporation was filed September 5, 1901. A copy of its certificate of incorporation is Exhibit 11 of this stipulation. It is a holding company and controls $955,000 out of $1,316,900 par value voting Common Stock and all of the non-voting Common Stock of Richmond, Fredericksburg & Potomac Railroad Company. Said latter railroad company owns and operates a line of railway between Washington, D. C. and Richmond, Virginia, and other transportation properties.

"9. On October 31, 1930, and prior thereto, the capital stock of R-W Co. was owned in equal parts, and continues so to be owned in equal parts, by six railroad companies, namely: Pennsylvania Railroad Company, Baltimore & Ohio Railroad Company, Atlantic Coast Line Railroad Company, Southern Railway Company, Seaboard Air Line Railway Company and Chesapeake & Ohio Railway Company. A copy of a balance sheet of R-W Co. as of December 31, 1901, is Exhibit 12 of this stipulation. On said date the authorized capital stock of R-W Co. was $3,000,000, divided into 30,000 shares having par value of $100 per share. Also on said date there were issued and outstanding 26,700 shares of its capital stock, of which Seaboard No. 2 owned 4,450 shares which were pledged as aforesaid under the First Mortgage.

"10. On September 18, 1930, the board of directors of R-W Co. adopted a resolution declaring a dividend of 50% on the capital stock, payable in stock on and after October 31, 1930, subject to approval by the stockholders of an increase in the authorized capital stock of the company from $3,000,000 to $5,000,000 and the filing of an appropriate amendment of the charter to evidence such increase. A copy of the board resolution is Exhibit 13 of this stipulation. Prior to the board meeting A. J. County, Vice-President of R-W Co., sent to each member of the board a letter dated March 12, 1930, a copy of which is included in Exhibit 14 of this stipulation. Included in said exhibit are also copies of correspondence as follows:

> "Letter dated June 28, 1932, from T. W. Mathews, Secretary of Seaboard Air Line Railway Company to J. Taney Willcox, Secretary of Richmond-Washington Company;

"Reply letter dated July 15, 1932, to Mathews from A. J. County, President of Richmond-Washington Company;

"Letter dated August 2, 1932, from Mathews, signed as Treasurer for Receivers, to County;

"Letter dated August 3, 1932, from County to Mathews.

"11. On October 10, 1930, the stockholders of R-W Co. adopted a resolution authorizing the increase of the authorized capital stock from $3,000,000 to $5,000,000 and approving the issuance and disposition of such increase in whole or in part by stock dividend, or by sale or otherwise, at a price or prices not less than par, at such time or times, in such manner, and upon such terms as should be by the board of directors declared and prescribed. A copy of such resolution is Exhibit 15 of this stipulation. A copy of the amendment to the charter filed in accordance with such resolutions of the board and of the stockholders is Exhibit 15A of this stipulation.

"12. On October 31, 1930, pursuant to said action of the board and the stockholders of R-W Co., a 50% stock dividend was paid by said Company to its stockholders, as a result of which certificates evidencing 2,225 shares were delivered to defendant Railway Company on said date in respect of 4,450 shares theretofore held by it and pledged under the First Mortgage as aforesaid. Upon receipt thereof defendant Railway Company continued to hold certificates for said 2,225 shares, and upon appointment of Receivers of defendant Railway Company such Receivers continued and still

continue to hold certificates for such shares in their possession.

"13. From 1901 to 1930, both dates inclusive, R-W Co. paid dividends on its capital stock as follows:

Year	Dividend Per Share Per Annum
1901	None
1902	$3.00
1903-5	4.00
1906-7	None
1908-15	4.00
1916	5.00
1917-22	6.00
1923	7.00
1924-25	8.00
1926-28	10.00
1929	10.50
1930	16.50 and stock dividend of 50%

"14. The balance sheets of R-W Co., as at December 31, 1929, and December 31, 1930, are, respectively, Exhibits 17 and 18 of this stipulation. Immediately prior to the issuance of such stock dividend the book value of each of the 26,700 shares of capital stock then outstanding was $263.75, and immediately after the issuance the book value of each of the 40,000 shares then outstanding was $175.83.

"15. On or about September 28, 1901 (the date of the delivery of 4,450 shares by Seaboard No. 1 under the First Mortgage), R-W Co. had no substantial accumulated net earnings. On or about September 28, 1901, the date of the delivery of 4,450 shares of R-W Co. stock under the First Mortgage, the book value of each of such shares was approximately $100.00. The said stock dividend was paid out of and charged against the profit and loss account of R-W Co.

"16. From and after December 23, 1930 (the date of appointment of Receivers herein), the Receivers have received and retained cash dividends on R-W Co. stock as follows:

Rate Per Share	Date Payable	Date Received	Amount
$3.00*	December 31, 1930*	December 31, 1930*	$ 20,025.00*
2.25	March 31, 1931	March 31, 1931	15,018.75
2.25	June 30, 1931	July 1, 1931	14,996.25
		July 15, 1931	22.50
2.25	September 30, 1931	October 3, 1931	15,018.75
2.25	December 30, 1931	January 4, 1932	15,018.75
2.25	March 31, 1932	April 4, 1932	5,006.25
1.00	June 30, 1932	July 19, 1932	2,225.00
1.00	March 1, 1933	March 1, 1933	2,225.00
2.00	June 30, 1933	July 5, 1933	4,450.00
2.00	December 30, 1933	January 2, 1934	4,450.00
4.00	March 31, 1934	April 2, 1934	8,900.00
4.00	March 30, 1935	April 2, 1935	8,900.00
4.00	March 31, 1936	March 31, 1936	8,900.00
1.00	December 15, 1936	December 16, 1936	2,225.00
1.00	December 26, 1936	January 8, 1937	2,225.00
6.00	December 22, 1937	December 27, 1937	13,350.00
			$142,956.25

*Payable to stockholders of record as of December 18, 1930, pursuant to action of board of directors of R-W Co. prior to that date.

"Of the above dividends, those received by the Receivers from December 31, 1930, to January 4, 1932, (both dates inclusive), were paid in respect of 6,675 shares of R-W Co. and from April 4, 1932, to the present time in respect of 2,225 shares; after January 4, 1932, cash dividends paid in respect of 4,450 shares were received and retained by the Trustee of the First Mortgage and cash dividends in respect of 2,225 shares have been received and retained by the Receivers." (From December 27, 1937 to date there have been received by the Receivers cash dividends upon the 2,225 shares amounting to $11,125.)

The Trustee of the First Mortgage made no

claim whatever of a right to possession of the 2,225 shares until *April 15, 1938* (R. 26), when a joint written demand by the Trustee of the First Mortgage and the Trustees of the Refunding Mortgage was served on the Receivers for delivery of the shares and payment over to the Trustee of the First Mortgage of the amounts of the dividends paid to the Receivers on both the 4,450 shares and on the 2,225 shares. The amounts of the dividends then aggregated $142,956.25, including $20,025.00 payable on December 31, 1930, to stockholders of record of the Richmond-Washington Company as of December 18, 1930.

That the Trustee of the First Mortgage, however, had been made plainly aware as early as April, 1932, that the stock dividend had been declared and that the shares were in the possession of the Receivers is conclusively shown by two letters (R. 83-84) passing between T. W. Mathews, Secretary of the Seaboard, and J. A. Wherrett, Secretary of The Continental Trust Company, the Trustee of the First Mortgage. For on March 11, 1932, Mr. Wherrett wrote Mr. Mathews as follows:

> "We only today received your letter of February 17th advising us the dates in 1931 on which dividends were paid on the capital stock of the Richmond-Washington Company.
>
> "Will you please advise us promptly as possible the dates and amounts of any stock dividends declared on the capital stock of Richmond-Washington Company since 1901 and also the dates and amounts of cash dividends paid on such shares after April 1, 1931, the date on which default occurred under the First

Mortgage from your Company to The Continental Trust Company as Trustee, dated April 14, 1900.

"You will note that this letter is signed by The Continental Trust Company, whose corporate existence as a fiduciary is being maintained solely for legal reasons, its business having been merged with the Maryland Trust Company."

to which Mr. Mathews replied on April 5, 1932:

"Replying to your letter of the 11th ultimo with respect to dividends paid on the capital stock of the Richmond-Washington Company.

"In 1930 a stock dividend of 50% was declared payable to stockholders of record at the close of business on October 21, 1930. This dividend amounted to 2,225 shares.

"The dates and amounts of cash dividends paid on the capital stock after April 1, 1931, are as follows:

Date	On 4,450 Shares	On 2,225 Shares	Total
June 30, 1931.....	$10,012.50	$ 5,006.25	$15,018.75
Sept. 30, 1931.....	10,012.50	5,006.25	15,018.75
Dec. 31, 1931.....	10,012.50	5,006.25	15,018.75"

This, however, was not the only or earliest notice to the Trustee of the First Mortgage of the fact of the existence and possession of these shares by the Receivers and their claim of dominion thereover. For as shown by Section 17 of the stipulation (R. 13), counsel for Trustee were duly served on June 9, 1931, with copies of Receivers' Application No. 28, Section VII of which dealing with the sale and transfer to William H. Coverdale of one share of stock to qualify

him to represent the Seaboard as a director on the board of the Richmond-Washington Company, expressly recites that the defendant Railway Company is the owner of 6,675 shares of the capital stock of Richmond-Washington Company and that "4,450 shares of such stock * * * are pledged under the Seaboard Air Line Railway First Mortgage and 2,225 shares * * * are held unpledged in the treasury of the Receivership Estate."

On April 4, 1931, the Receivers filed their Application No. 19 for authority to issue and presently sell $4,000,000 of Receivers' Certificates. This application was referred to James E. Heath, Esq., as Special Master, who held a hearing on April 10, 1931 (R. 117). Among the exhibits introduced at the hearing was Exhibit No. 7 listing in connection with the testimony of R. P. Jones, the Receivers' Chief Finance and Accounting Officer, a statement of *unpledged securities* owned by Seaboard Air Line Railway Company as of December 23, 1930. This exhibit, which is No. 26 to the stipulation (R. 114) lists stocks of Richmond-Washington Company at a par value and book value of $222,500.00, and shows this stock as being 16⅔% of the stock of the Richmond-Washington Company owned by the Seaboard. The Trustee of the First Mortgage and the Trustees of the Refunding Mortgage were parties to the proceeding on Application No. 19 and were represented at the hearing by counsel. In identifying this exhibit Mr. Jones testified:

> "Q. Have you a list of what we refer to as the free assets of the Seaboard Air Line Railway Company that were in existence on

the day of the Receivership and came into the hands of the Receivers?

"A. Yes, sir. I have two statements. The first is a statement of unpledged securities owned as of December 23, 1930, exclusive of the Company's own issues.

"Q. Now when you say 'free assets' those were the stocks and bonds and notes not pledged under any of the mortgages or other instruments of the Seaboard Air Line Railway Company?

"A. That is correct." (R. 111).

The hearing on Application No. 19 resulted in a decree (Order No. 19A), dated April 22, 1931, providing for a lien in favor of the Receivers' Certificates upon

> "All the property and assets of every nature and description of the Railway Company and of the Receivers, whether real, personal or mixed, now or at any time hereafter, prior to the termination of the Receivership, in the possession or under the control of the Receivers (including without limitation of the foregoing general description, securities, equipment obligations, evidence of indebtedness * * *." (R. 125).

Thereafter, when the Receivers' Certificates issued under Order No. 19A were refunded pursuant to the provisions of Order No. 63, entered on February 15, 1933, and when the Receivers' Certificates issued under the latter order were again refunded by Orders Nos. 160A and 160B, entered on March 20, 1935, the identical provisions as to lien were embodied in these de-

crees and the exhibit showing the unpledged securities introduced by the witness R. P. Jones was made a part of the record on the hearings of each of these later applications. At both these later hearings the Trustees of both the First Mortgage and of the Refunding Mortgage were represented by counsel.

In view of these proceedings it is clear that the Receivers throughout the three proceedings involving the issuance of Receivers' Certificates had treated the 2,225 shares as assets of the Receivership Estate available for subjection to the lien of the Receivers' Certificates.

As we shall point out hereafter, the question of the right of the Court under the decrees to subject the stock to the lien of the certificates involves much broader considerations than any mere question of estoppel of the Trustees of either the First Mortgage or of the Refunding Mortgage arising from its silence, its failure to interpose objections during the course of the proceedings and its failure even to make demand for the 2,225 shares or cash for eight years after the Receivership had begun. The certificates of stock were in the actual physical possession of the Receivers and as we shall undertake to show, were clearly within the scope of the Court's power in connection with the decrees authorizing the issuance of the Receivers' Certificates, irrespective, even of any claims or liens in favor of the Trustee of the First Mortgage, or the Trustees of the Refunding Mortgage.

ARGUMENT.

As indicated in the preceding petition, it is contended that the court below, in addition to its failure to apply the applicable State law with respect to the nature of a stock dividend and the rights as between pledgor and pledgee erroneously held the Trustee of the First Mortgage to be entitled to a lien upon and the possession of the 2,225 stock dividend shares, the cash dividends declared thereon and the cash dividends declared upon the 4,450 shares owned by the Railway Company and pledged with the Trustee of the First Mortgage, collected by the Railway Company prior to any demand for the pledge thereof by the Trustee of the First Mortgage—and this despite the pledge provisions of the First Mortgage, the appointment of the Receivers, and the subjection of both the stock and cash dividends to the lien of the Receivers' Certificates authorized by decrees of the District Court.

It is not disputed that if the 2,225 shares are properly within the category of dividends, as that term is used in Section 1 of ARTICLE THREE of the Mortgage, the Railway Company had the full right to them at all times prior to an event of default. And it is also undisputed that no event of default under the First Mortgage had occurred until after the Receivership and therefore after the 2,225 shares had been delivered to the Railway Company. The District Court in its memorandum in support of its decree (R. 185) and the Special Master in his report (R. 132) both recognized that the right of a pledgee to receive dividends declared upon shares of stock held in pledge is an incident to the pledgee's special ownership only *in the absence of an agreement to the contrary.*

The majority of the Circuit Court of Appeals concluded that the 2,225 shares were not a dividend in any true sense, but a distribution of capital assets. This conclusion was reached by completely ignoring the applicable Maryland law, as is clearly pointed out in the dissenting opinion of Judge Soper.

I.

The Circuit Court of Appeals for the Fourth Circuit Has Rendered a Decision in Conflict With Section 34 of the Federal Judiciary Act and the Decisions Of This Court.

This Court has declared that the proper construction of Section 34 of the Federal Judiciary Act (28 U. S. C. A., Sec. 725) requires that Federal Courts in all cases, except in matters governed by the Federal Constitution or by Acts of Congress, apply the entire body of substantive law governing identical actions in the State courts. *Erie R. Co.* v. *Tompkins*, 304 U. S. 64, 82 L. Ed. 1188; *Ruhlin* v. *New York L. Ins. Co.*, 304 U. S. 202, 82 L. Ed. 1290. It has prescribed the duty of the Federal Courts in every such case to be "to ascertain from all the available data what the State law is and apply it rather than to prescribe a different rule, however superior it may appear from the viewpoint of 'general law' and however much the State rule may have departed from prior decisions of the Federal Courts." *West* v. *American Teleph. & Teleg. Co.*, 311 U. S. 223, 85 L. Ed. 139; *Fidelity Union Trust Co.* v. *Field*, 311 U. S. 169, 85 L. Ed. 109; *Stoner* v. *New York Life Ins. Co.*, 311 U. S. 464, 85 L. Ed. 284.

The majority opinion of Judge Parker apparently

concedes that under the Maryland law if this had been a question as between life tenant and remainderman rather than between pledgor and pledgee, the Railway Company would have been entitled to the 2,225 shares. After citing Federal and State Court cases holding that stock dividends are not really dividends and that it would violate that doctrine to hold the 2,225 shares to be dividends even though they were declared based upon surplus earnings which could have been as well distributed in cash as in stock, the majority opinion says:

> "The only argument against this position is based upon certain Maryland decisions, beginning with *Thomas* v. *Gregg*, (1894) 78 Md. 545, 28 Atl. 565, to the effect that under a trust giving the income of property to a person for life with provision that the principal be paid to others upon his death, dividends, whether in stock or in cash, to the extent that they represent profits arising subsequent to the creation of the trust, will be distributed to the life tenant as income of the trust estate. We note in passing that the rule of these decisions has been changed by statute in Maryland, as it has in New York. See Flack's Annotated Code of Maryland, art. 75B, sec. 5. The rule, however, does not solve our problem; for the question with which it deals is, not the nature of dividends and what is to be included within the terms, but the nature of corporate income and how it should be apportioned between life tenant and remainderman under a trust, the rule being applicable to true dividends paid in cash as well as to stock dividends representing capitalization of corporate surplus. No such question is presented here.

> There is no reservation of income to the Seaboard. Only dividends are reserved; and, as to these, there is no question as to who is entitled to them, once they are found to be dividends within the meaning of the reservation. Upon this question the rule as to apportionment of income of corporate stocks between life tenant and remainderman manifestly cannot be determinative; for that rule, as applied to stock dividends, does not mean that stock dividends are to be treated in all respects as cash dividends, but merely that, when corporate income is capitalized and stock certificates are issued evidencing the capitalization, a life tenant entitled to the income of the trust property is entitled to the certificates. Since it is not income but dividends which is reserved to the Seaboard, our problem is to decide, not what is properly included in income, but what is properly included in 'dividends,' * * *."

This not only ignores the Maryland law but also ignores the provisions of the First Mortgage heretofore quoted, which clearly showed that the Railway Company, as long as it was not in default should be entitled to the income and increment of pledged securities, although referred to in the mortgage as dividends or interest, as the case might be, on pledged securities. The falacy of the reasoning of the majority is completely exposed by the dissenting opinion. As well said by Judge Soper:

> "We are obliged in the pending case to search for and apply the Maryland law in the interpretation of a trust indenture from a railroad company to a trustee to secure an issue of mortgage bonds, and to construe a clause of

the contract that is without precise precedent in judicial decision in Maryland or elsewhere, so far as search of the authorities has disclosed. Certain bonds and stocks were pledged with the trustee by the Railroad Company as security for the mortgage debt, including 4,450 shares of the Richmond-Washington Company, one-sixth of the outstanding stock of a holding company which owned the Richmond, Fredericksburg and Potomac Railroad. As to these securities the mortgage provided in effect in Article 3, Section 1, that unless the Railroad Company should be in default in the payment of some interest upon its bonds for a period of six months, the trustee should not be entitled to collect the interest of any of the bonds or claims or indebtedness pledged with the trustee, and the Railroad Company should be entitled to receive all interest paid or dividends declared in respect of any bonds or stocks so pledged. Article 9 of the mortgage provided that until some default, the Railroad Company should be permitted to retain actual possession of the mortgaged premises and manage and operate and use the same, and collect and receive the earnings, income, rents and profits thereof. It is plain from these provisions of the contract and from the continued operation of the mortgaged property by the mortgagor, that the Railroad Company was expected to hold and operate the railroad and to enjoy the income from its operation and its investments until default, while the trustee was to hold the tangible property and securities described in the mortgage as a pledge to ensure the payment of the mortgage debt.

"It was under these circumstances and before any default on the part of the Railroad Company had occurred, that the Richmond-

Washington Company declared a stock dividend of 50 per cent, which amounted to 2,225 shares on the holdings of the Railroad Company, and was delivered to it. The dividend was based on earnings which had accrued subsequent to the delivery of the stock in pledge to the trustee named in the mortgage. Now that the Railroad Company is in the hands of receivers, the question has arisen as to whether this dividend belongs to the trustee under the mortgage, as the representative of the bondholders, or to the receivers of the Railroad Company subject to the claims of other secured or general creditors.

"We are not aided in answering this question by the general rule in Maryland and elsewhere that a dividend accruing upon pledged stock belongs to the pledgee; for a contrary provision has been made in the terms of the contract. We must determine whether under the Maryland law the provision of the contract, that the Railroad Company until default is entitled to dividends on the pledged stock, covers the stock dividend in this case. We are told that the stock dividend does not fall within the terms of the contract because a stock dividend is not a true dividend. The leading authorities cited for the rule in the opinion of the Court in the pending case are the well known decisions of *Gibbons* v. *Mahon*, 136 U. S. 549, and *Eisner* v. *Macomber*, 252 U. S. 189. These decisions are based upon the logical theory that a stock dividend really takes nothing from the property of the corporation and adds nothing to the interest of the stockholders; that it is not a realization of profits by the stockholders but a transfer of surplus to capital so as to be no longer distributable; while an ordinary dividend is a distribution of profits which the cor-

poration makes and the stockholder realizes. Moreover, it is said that the stock dividend in the pending case cannot fairly be described as a dividend payable to the Railroad Company within the meaning of the contract, because otherwise the interest of the Railroad Company in the Richmond-Washington Company, that originally amounted to a one-sixth interest, would be reduced to a one-ninth interest, and the security of the bondholders would be impaired.

"These authorities and others like them, present the reasoning upon which is founded the so-called Massachusetts rule governing the apportionment of dividends between life tenant and remainderman under a trust set up by a will or deed. This rule is that stock dividends, regardless of their source, are invariably treated as corpus, and cash dividends are classified as income. If it is applied by analogy to the facts of the pending case, we must hold that the stock dividend in question belongs to the trustee under the mortgage. *But the Massachusetts rule, although favored in the federal courts and in other jurisdictions, is not recognized in the law of Maryland. By a long line of decisions of the Court of Appeals of Maryland, a different theory known as the Pennsylvania rule was firmly embedded in the law of the State when the mortgage under consideration was executed in 1900 and there remained until it was repealed by Chapter 580 of the Laws of Maryland of 1939.*" (Italics supplied.)

There appear to be no cases, in Maryland or elsewhere, directly involving the particular question of the nature of a stock dividend and the rights as between pledgor and pledgee where dividends are reserved to

the former, but a clearly analogous question has been repeatedly litigated, viz.: the rights in and the nature of a stock dividend as between life tenants and remaindermen under trusts of corporate stocks. This question, arising many times in the courts of nearly every State, has given rise to divergent views, which have crystalized into two opposing legal attitudes, generally referred to as the "Pennsylvania Rule" and the "Massachusetts Rule." Generally speaking, the Maryland decisions follow the Pennsylvania Rule with variations immaterial to the principle applicable to the question at issue here.

The Pennsylvania and the Maryland decisions, followed in many other States, treat a stock dividend as income rather than as corpus, thus giving such stock to the life tenant rather than vesting title in the remainderman. The Massachusetts rule generally holds the contrary and treats stock dividends as part of the corpus and refuses the stock to the life tenant. Some decisions take a middle ground (sometimes in an effort to carry out the supposed intention of a testator or creator of a trust) and divide the dividend stock between the life tenant and the remainderman under a formula designed to preserve unimpaired the value of the original stock held in trust, while at the same time giving the life tenant a part of the dividend stock regarded as an equivalent of the proper proportion of the corporate surplus which but for the stock dividend would have been distributed as cash dividends. See Notes 24 A. L. R. 9; 50 A. L. R. 375; 72 A. L. R. 981, and 83 A. L. R. 1261.

The Maryland rule clearly holds that stock dividends declared out of surplus income are to be treated

as income and in principle clearly repudiates contentions such as those accepted by the court below that a stock dividend is not a dividend at all. The rule was adopted by the Court of Appeals of Maryland in the case of *Thomas* v. *Gregg*, 78 Md. 545, 28 Atl. 565, and was reaffirmed in, and applied to, the varied circumstances of numerous subsequent cases until its repeal by Chapter 580 of the laws of Maryland in 1939.

Quinn v. *Safe Deposit and Trust Co.*, 93 Md. 285, 48 Atl. 835;
Smith v. *Hooper*, 95 Md. 16, 51 Atl. 844;
Safe Deposit and Trust Co. v. *White*, 102 Md. 73, 61 Atl. 295;
Ex Parte Humbird, 114 Md. 627, 80 Atl. 209;
In re Northern Central Ry. Dividend Cases, 126 Md. 16, 94 Atl. 338;
Miller v. *Safe Deposit and Trust Co.*, 127 Md. 610, 96 Atl. 766;
Krug v. *Mercantile Trust and Deposit Co.*, 133 Md. 110, 104 Atl. 414;
Spedden v. *Norton*, 159 Md. 101, 150 Atl. 15;
Baldwin v. *Baldwin*, 159 Md. 175, 150 Atl. 282;
Heyn v. *Fidelity Trust Co.*, 174 Md. 639, 1 Atl. (2d) 83.

Without regard to this clear expression of the Maryland rule, or the admonition of this Court that "the proper function of the * * * Federal Court is to ascertain what the State law is, not what it ought to be" (*Klaxon Co.* v. *Stentor Elec. Mfg. Co.*, 313 U. S. 487, 497, 85 L. Ed. 1477, 1481), the Circuit Court stated that to apply the rule established by analogous decisions of the Court of Appeals of Maryland would

be to indulge in vain speculations. And yet, as noted by its dissenting member, there is no other guide, and the Circuit Court, itself, supported its conclusion by the citation of analogous decisions of jurisdictions that have adopted the "Massachusetts Rule"—the rule repudiated by the Court of Appeals of Maryland.

The "available data" upon which to determine what the law is being analogous decisions, obviously the decisions of this Court required the Circuit Court to reason from analogous Maryland decisions and not attempt to establish a "superior rule" by analogy from contrary decisions of other jurisdictions.

II.

The Lien of the Receivers' Certificates Attached to Both Stock and Cash Dividends.

For convenient emphasis we quote again the language of the decrees providing for the lien of the Receivers' Certificates:

> "(1) upon the surplus earnings and income hereafter coming into the hands of the Receivers prior to the termination of the Receivership, after paying out of such earnings and income, however derived, the expenses of the Receivership and of operation, and such other amounts for similar purposes as the Court may direct, and upon any property or interest therein purchased with such surplus earnings and income;
>
> "(2) upon all the property and assets of every nature and description of the Railway Company and of the Receivers, whether real,

personal or mixed, now or at any time hereafter, prior to the termination of the Receivership, in the possession or under the control of the Receivers (including, without limitation of the foregoing general description, securities, equipment obligations, evidences of indebtedness, rolling stock, other equipment, and the interest of the Railway Company and of the Receivers in equipment under equipment agreements); and

"(3) upon all the property and assets, real, personal or mixed, which are surrendered or conveyed by the Receivers to any successor to the Receivers and which are subject to the lien of the Receivers' Certificates at the time of such surrender or conveyance, and upon the rents, income, issues and profits thereof; and upon all property thereafter acquired by the successor to the Receivers which is appurtenant to and used in connnection with the lines of railroad and other property then remaining subject to the lien of the Receivers' Certificates, and all the rents, income, issues and profits therefrom;

prior to any lien thereon, direct or indirect, of the following general mortgages of the Railway Company, viz.:

"First Mortgage, dated April 14, 1900, to The Continental Trust Company, Baltimore, Maryland, Trustee, and all supplements thereto;

"Refunding Mortgage, dated October 1, 1909, to The New York Trust Company and Mortimer N. Buckner, as Trustees; * * *."

(R. 125).

In the teeth of this all-inclusive language the

majority opinion of the Circuit Court of Appeals summarily disposes of this important question in the following language:

> "So far as the claim of lien by reason of the issuance of Receivers' Certificates is concerned, it is a sufficient answer that no holder of any of these certificates is before us claiming any such lien. We do not interpret the orders authorizing the certificates, however, as creating such lien. These orders created a first lien on the property of the Seaboard 'in the possession or under the control of the Receivers,' but this did not reach the shares of stock of R-W Company since they were not in the Receivers' possession or under their control. It is true that the certificates covering the stock dividend shares were in their possession, but these certificates were not the shares of stock, which are intangible rights, but mere evidence thereof. The original shares had been pledged with the trustee and were not in any sense in the possession of the Receivers; and the stock dividend shares, as we have shown, attached to these as a matter of law. The stock certificates, of course, had none of the attributes of negotable paper.
>
> "The shares, it should be noted, were not mentioned in the orders authorizing the certificates. It is true that they were listed as free assets in an inventory furnished the Court at the time of the application for the orders; but the inventory was furnished to show the financial condition of the company as a justification for the orders. No issue was presented as to whether the shares were free assets or not; and the orders contain no provision which could properly be construed as subjecting to the

> lien of the Receivers' Certificates any stock subject to the lien of a pledge. There is no contention that the original 4,450 shares were subjected to the lien of the certificates; and we think that stock dividend shares stand on precisely the same footing."

One of the grounds stated in this quotation for rejection of the Receivers' contentions, properly made on behalf of the numerous holders of Receivers' Certificates, is that although the decrees created a first lien on the property of the Seaboard in the possession or under the control of the Receivers,

> "this did not reach the shares of stock of the R-W Company since they were not in the Receivers' possession or under their control. It is true that the certificates covering the stock dividend shares were in their possession, but these certificates were not the shares of stock, which are intangible rights, but mere evidence thereof."

The fallacy of this contention is emphasized by the language of the decree of the Receivership Court, dated May 29, 1931, extending the Receivership to the properties covered by the First Mortgage on the Bill of Complaint of the Trustee to foreclose that mortgage which explicitly provides

> "That the Receivers heretofore appointed * * * be and they hereby are appointed * * * Receivers of all and singular the railroads, rolling stock, equipment, franchises, rights, interests, property and premises of every kind and description and wheresoever located, belonging to the defendant, Seaboard Air Line

> Railway Company, and covered by and embraced in or under said First Mortgage (other than the securities and other property pledged to *and now in the possession of the complainant*, The Continental Trust Company) situate within the jurisdiction of this Court, and of the tolls, earnings, income, rents, issues and profits of the same and every part thereof, * * *."* (Italics supplied.)

It ignores the fact that the First Mortgage Trustee did not have possession or control of the shares and does not have to this day. It did not hold these shares in pledge, for there has never been any delivery, and does not now hold them in pledge. The most the Trustee could have is to convert an inchoate right of pledge into a positive one and have these shares subjected to the lien of the Mortgage. With due deference to the majority of the Court of Appeals, it seems absurd to say that the stock dividend having been declared to the Railway Company and the stock certificates for 2,225 shares delivered to the Receivers, they and the Court, of which the Receivers are merely the instrumentality, did not have possession and control of the shares.

The other reason given by the majority opinion is equally fallacious, viz.: That "no holder of any of these certificates is before us claiming any such lien." The Receivers' Certificates were issued by the Receivers pursuant to decrees of the Court. Under the terms of the decrees authorizing the issuance of the

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* This decree is not a part of the record printed pursuant to stipulation by the parties for the purpose of this petition, but is a part of the typewritten transcript of the entire record on file with the Clerk of this Court.

Receivers' Certificates the Receivers are entitled to the income on all assets, both real and personal, subjected to the lien of the certificates. Accordingly, apart from the fact that the Receivers can be said to be representatives of the Receivers' Certificates in a trust relationship and under a duty to protect their interests the Receivership Estate itself has a direct interest in the continued receipt of the income from these shares of stock. (See the Decree—Order 160A —R. 130).

The intention to subject to the lien all securities and choses in action in the possession of the Receivers could hardly be more clearly and directly expressed. We have shown beyond any possible doubt that it was the intention of the Receivers to include these shares in the pool of free assets to be subjected to the lien of the Receivers' Certificates; that there was ample notice to the Trustees of this intention through their counsel who were present at the hearings by the testimony of R. P. Jones on the hearing on Application No. 19 and the introduction of the statement of unpledged securities (R. 111), and through the Receivers' Application No. 28, served June 9, 1931 (see *ante*, p. 17 of this brief) the Receivers were dealing with and exercising open dominion of these shares.

No contention has been made that the Court lacked the essential power to subject the 2,225 shares to the lien of the certificates, but the argument is that there was no intention of the Court to do so. If, however, such intention, express or implied from the circumstances shown by the record on those hearings did exist, any intention of the Mortgage Trustee to the contrary, not disclosed at the hearings, is immate-

rial because they could not remain silent and now be heard to say that the record as made on the Receivers' Certificates applications is not one upon which the holders of Receivers' Certificates could rely for the nature and extent of the security extended by the Court decrees to the certificates.

It is a thoroughly accepted principle that a judgment or decree is conclusive, not only upon the questions actually decided and determined but upon all matters which might have been litigated and decided in the suit and within the scope of the proceeding. Accordingly, where the second suit or proceeding relates to the same subject matter as the first, all matters which might have been litigated are conclusively settled by the former judgment or decree and the rule applies where defenses which were available in the first proceeding, but not then set up, are sought to be used in the second action either by way of defense or as the foundation for a claim for relief.

Town of Beloit v. *Morgan*, 74 U. S. 619, 19 L. Ed. 205;
Cromwell v. *Sac County*, 94 U. S. 351, 24 L. Ed. 195;
New Orleans v. *Citizens' Bank*, 167 U. S. 395, 42 L. Ed. 202;
Southern Pacific R. R. Co. v. *United States*, 168 U. S. 1, 42 L. Ed. 355;
Fitch v. *Stanton Tp.* (C. C. A. 8), 190 Fed. 310.

The entire record on Application No. 19 (including the statement of unpledged securities introduced at that hearing, above referred to) was re-introduced and made a part of the record on the hearings of both

Applications Nos. 63 and 160. The Trustees of both the First Mortgage and of the Refunding Mortgage were parties to the two later proceedings. The Receivers were under no more obligation to make pointed reference to the 2,225 shares of stock in connection with the proposed lien of the Receivers' Certificates than they were to single out and make specific allusion to a particular line of railroad or other property of the Railway Company. If the Trustees of the mortgages regarded their claims to the stock to be such that the lien of the certificates could not be imposed thereon, it was incumbent upon them to put forward that contention as an issue to be then and there decided by the Court.

It is not necessary to ground the validity of the lien of the Receivers' Certificates upon the elements of estoppel plainly apparent from the record, but discounted in Section VI of the Master's report (R. 182 et seq.). For as we view the case the Receivers' Certificates decrees are binding upon the Trustee, regardless of any question of estoppel. But the argument in the report on this point is that "the Receivers have not been adversely affected in any way by the silence of the Trustees." The Receivers are officers of the Court, and the argument of the report ignores the clear fact that to permit the Trustee now to seize possession of the stock would be to impair the value of the security of the Receivers' Certificates to the extent of several hundred thousand dollars. Whether the silence and inaction of the Trustee (apart from the cash dividends involved, the book value of the 2,225 shares is nearly $400,000, see p. 14, *ante*.), be regarded as estoppel

in pais, estoppel by record or a mere waiver of their rights now asserted, the result is the same. Compare:

> *Mercantile Trust Co.* v. *Tennessee Cent. R. Co.* (M. D. Tenn., 1921), 291 Fed. 462;
> *Mercantile Trust Co.* v. *Kanawha R. Co.* (C. C. A. 6th, 1893), 58 Fed. 6;
> *Kneeland* v. *Luce Co.* (1891), 141 U. S. 491, 35 L. Ed. 830;
> *Miltenberger* v. *Logansport, Etc. R. R. Co.* (1882), 106 U. S. 286, 27 L. Ed. 117;
> *Pillinger* v. *Beaty* (C. C. A. 4th, 1920), 265 Fed. 551.

As to the collection by the Receivers of cash dividends on both the 4,450 shares and on the 2,225 shares, there was a clear waiver of the right of the Trustee to reclaim them from the Receivers.

Nor is it material that the result of these decrees has been to displace or subordinate the claims of the Mortgage Trustee to the stock and cash dividends. The act of the Court in the form of the decrees in subjecting the stock is inescapable. On this phase of the case the report of the Master (R. 162 et seq.) proceeds upon what, we submit, is an entirely erroneous conception of the effect of the decrees. It says:

> "If the stock dividend and the cash dividends had been, when the orders in question were made, free assets of the Railway, I agree with the Receivers that they would have become thereby subject to the lien of the certificates. The applications and the orders were broad enough to cover them. I have tried to show that they were not free assets of the Railway, but were held, just as the original

> 4,450 shares were held under the pledge to the Trustee of the First Mortgage. This would sufficiently dispose of this question if there were no more to the contention of the Receivers. But, as I understand it, the Receivers go far beyond this, and make the claim that, even though, in the absence of the orders in question, the dividends in question might have been subject only to the pledge of the First Mortgage Trustee or to that of the Refunding Mortgage Trustees, these orders have had the effect of deciding that these dividends were not pledged under either of these mortgages, but were a part of the free assets of the Railway. In other words, the Receivers make the contention that, when the first of these applications was before the Special Master and the Court, respectively, and afterwards when the second and third were before the Court, the question was squarely raised and put in issue, as to whether the stock dividend, was or was not pledged, and that by the orders entered upon these applications it was adjudged that it was unpledged."

The report assumes that in order for the lien of the Receivers' Certificates to have become fixed upon the stock and upon the cash dividends that had come into the hands of the Receivers, the stock and the cash must have been free assets of the Railway Company, but the report argues that the shares were not free assets but "were *held* under the pledge to the Trustee of the First Mortgage." The report makes the point that this stock was not listed in the exhibits to Application No. 19 as a free asset. That is true, but the report itself comments upon the fact that:

> "Among the exhibits was Exhibit C-1, showing the securities pledged under the several gen-

> eral mortgages of the Railway. In this exhibit the 4,450 shares of R-W Co. stock were listed as pledged under the First Mortgage. There was no statement in the application showing what were the unpledged securities * * *. The prayer of the application was that the certificates be equally secured 'by a paramount lien upon the properties and assets of every nature and description of the Railway and/or of the Receivers (including * * * without limitation * * * securities and evidences of indebtedness and all other personal property) * * * in the possession or under the control of the Receivers,' * * *."

It is difficult to conceive of a broader statement than that quoted by the report itself of the intention in the application to subject to the lien of the certificates all and every class of securities then in the possession of the Receivers. That intention is not limited so as to exclude securities the status of which, as here, might later become the subject of controversy. The fact that the application does not list the 2,225 shares as among those pledged under the First Mortgage in connection with the notice in the various forms already discussed and the fact that the Receivers had the possession of and claimed the title to the 2,225 shares, provided an ample basis for the decrees, whose language, wholly free of any ambiguity, subjected this stock to the lien of the certificates.

The authority and power of the District Court to displace the lien of the First Mortgage upon the 2,225 shares and upon the cash dividends collected by the Receivers on both those shares and upon the 4,450 pledged shares, even if such a lien existed, is well established:

Wallace v. *Loomis*, 97 U. S. 146, 24 L. Ed. 895;
Union Trust Co. v. *Illinois Midland Co.*, 117 U. S. 434, 29 L. Ed. 963;
American Brake Co. v. *Pere Marquette R. R. Co.* (C. C. A. 6, 1913), 205 Fed. 14;
Mercantile Trust Co. v. *Tennessee Central R. Co.* (M. D. Tenn., 1921), 291 Fed. 462.

As stated by the Court in the case last cited (p. 467):

> "A court of equity administering railroad property either in a mortgage foreclosure case or in a creditors' suit, is charged with the duty of conserving and operating the property, so far as can practically be done, for the benefit of both public and private interests, and in the exercise of this duty of conservation and operation may, in a proper case, make such repairs, replacements and betterments and incur such operating expenses as are purely essential to such results, and make the certificates issued for money borrowed by the Receivers for such purposes a lien upon the corpus of the property, and, so far as necessary, prior to existing liens."

There are no limits to the power of a Court to subject to the lien of Receivers' Certificates all assets within its jurisdiction.

Under the decisions of this Court even prior notice to parties and lienholders is not essential to the validity of an order of a Court authorizing the issuance of Receivers' Certificates, which shall be a first lien on the property:

Union Trust Co. v. *Illinois Midland R. Co.*, *supra;*

Mercantile Trust Co. v. *Tennessee Central R. Co., supra;*
American Brake Co. v. *Pere Marquette R. Co., supra;*
Ames v. *Union Pacific R. Co.* (C. C. D. Nebr., 1896), 174 Fed. 335.

Secured creditors who are not parties to the suit when Receivers' Certificates are authorized have the right, however, to intervene and contend that the order displacing their liens should be reconsidered.

Considered even from that standpoint, it is submitted that there are no equities in favor of the Trustees. Though the Receivers' Certificates supplanted the liens of the mortgages, the testimony and evidence in records on the hearings of the Receivers' Certificates applications show conclusively that issuance of the certificates was necessary to the protection of the mortgaged properties and the preservation of the system. Under these circumstances the Court will do no violence to the rights or equities of the mortgages if it refuses to impair the security of the certificates by removal therefrom of the 2,225 shares and refuses to require the Receivers to pay over to either of the Mortgage Trustees the amounts of the cash dividends collected by the Receivers on both the 4,450 shares and the 2,225 shares and expended by them in good faith for the legitimate purposes of the Receivership. The Trustees of the Mortgages long since invoked the aid of the Court to preserve and manage the mortgaged properties in the interests of those respective trusts. They now seek the aid of the Court to capture and reduce to possession the stocks and cash and remove them beyond the jurisdiction of the Court, and of

the scope of the Receivership. Such aid should be denied.

The value of the 2,225 shares of nearly half a million dollars is a material asset involved in the appraisals of values of the Railway properties and existing securities in connection with proceedings for reorganization of the Seaboard System which are now pending. Moreover, the importance of giving effect to decrees of Receivership Courts upon the faith of which Receivers' Certificates are acquired by the investing public, is such that this question also deserves review and consideration by this Court.

CONCLUSION.

We think it sufficiently appears the questions presented in this case are of such a nature as to justify the assertion that the case comes within the provisions of paragraph 5(b) of Rule 38, which states the considerations controlling in the matter of issuing writs of certiorari in cases like this, and it is respectfully submitted that the petition should be granted.

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For Petitioners.

March 5, 1942.